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APRIL 1989
A CAHNERS PUBLICATION

# Industrial Distribution

THE BUSINESS MAGAZINE FOR INDUSTRIAL DISTRIBUTORS

SPECIAL:

**PARTNERS FOR PROFIT**

## Teamwork raises productivity at Florida Bolt

# Industrial Distribution

THE BUSINESS MAGAZINE FOR INDUSTRIAL DISTRIBUTORS

VOL. 78, NO. 4 APRIL 1989 A CAHNERS PUBLICATION

Florida Bolt's project team consists primarily of employees rather than managers.

cover photography by Red Morgan


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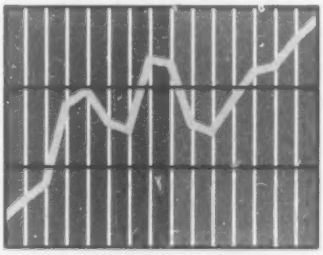

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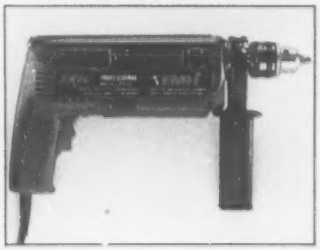

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# Partnering in action

*Many buyers want the distributor's service level, but insist on the manufacturer's price*

It's one thing to talk about the ideal of partnering; another to make it work. In this section we look at some of the insights that those with actual experience in partnering have shared with us in the preparation of this report and last year's report on partnering. We examine the real-world problems as well as the opportunities.

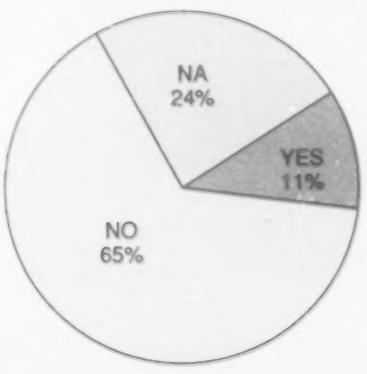
To begin with, whatever the misconceptions or misgivings about partnering, more and more of these relationships are being developed between distributors and buyers of MRO goods. And, the trend seems to be growing. In its elemental form partnering aims at an exchange of distributor stocking for a buyer commitment to purchase a line of goods.

But beyond those commitments is the understanding that the buyer and supplier will work as partners trying to solve problems rather than acting as two adversaries trying to score points. This working together to mutually solve problems is a radical departure from everything that has taken place in the American industrial marketplace to date. As a result, partnering doesn't just happen—it has to be developed.

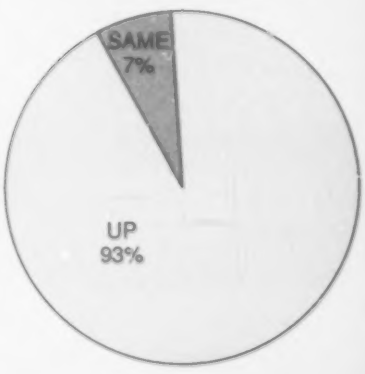
**The challenge of change.** One of the most fundamental changes taking place among industrial distributors is in the way they regard and

**Partnering**
**(two views)**

**Few distributors have partnering agreements. . .**




**But those with them expect to increase partnering over the next 5 years.**




SOURCE: DREF-NAW study, 1990

sell themselves. As we noted in last year's report, much of the early impetus came from industrial buyers. In recent years this has changed and industrial distributors are coming on strong. Through thoughtful self-examination many have rediscovered the essence of what really makes them unique and valuable in the eyes of astute industrial buyers.

The magic ingredient isn't products or prices, but service—especially the service that maximizes what distributors are good at, managing inventory. Using service as a criterion, the best-positioned industrial distributors are selling service like never before. For many it requires an extremely well-reasoned assault on the biases of industrial buyers who have been conditioned over the years to think of price whenever total cost comes up.

Industrial distributors also are finding that good partnering requires good management skills on their part. A case in point is the higher volume per customer that is implied in partnering. At first blush it would seem that just their increased volume would allow the distributor to bring in quantum gains in net profit. But appearances are deceiving. If a distributor wins partnering business and tries to service it the same way he services other accounts—without reducing handling costs—he often loses money. One of the reasons for this is that the average order size from the customer tends to drop significantly once the partnering agreement is in effect. Unless there's an easy, uncomplicated method for order filling the distributor is likely to take a bath.

**Selling.** Another factor that is critical to the success of partnering is the ability to sell the concept. Selling partnering is still usually more difficult for the distributor than the industrial buyer. Buyers following a tried and true eight-step

# Eight steps for buyers

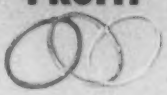
The eight steps that need to be followed if the buyer is initiating the partnering agreement:

1. Systems analysis. A complete examination of the paperwork and procedures involved with making the purchase must be made and an understanding of all the procedures the paper represents must be reached.
2. Selling. All who use the system—internally and externally—must be sold on the approach. They must be convinced that purchasing procedures will be streamlined, inventory will be reduced, and a better service level will follow.
3. Product line evaluation and selection. Groups of products that will lend themselves to the partnering approach must be identified.
4. Item analysis. In every product group, the individual items that make up the grouping must be examined fully in terms of past purchases, usage, suppliers, and pricing.
5. Evaluation and selection of supplier(s). A full search and evaluation must be made of every potential supplier of a partnering agreement.
6. Negotiation. Once purchasing has made a basic determination of the product scope and potential suppliers, it's time to sit down and start explaining and working out the details with the potential vendor.
7. Implementation. This consists of going through and working out the problems that weren't anticipated in the planning stage and insuring that the contract works in real life.
8. Audit. A systematic and continuing check to ensure that the procedures set up are used the way they were intended.

# Eight steps for distributors

Here are the eight steps that must be followed when the partnering is initiated by the industrial distributor:

1. Identification of customers or potential customers for whom a partnering agreement would be appropriate. In short, a smart distributor needs to do some scouting before he ever gets around to talking deals.
2. Make a presentation to customer candidates of the potential benefits of a well-conceived agreement. The objective is to win approval of the customer company to allow the distributor to make a detailed study of his operation to see if it lends itself to a partnering agreement.
3. Study. This involves a complete systems analysis of paper flow involved in purchasing, along with the gathering of statistical information to establish the base for determining benefits from an agreement covering the product line under consideration.
4. Concept. This is nothing short of the presentation of a plan for implementing a partnering agreement with the customer. The customer must be shown how he will benefit and what is expected in return.
5. Item analysis. A detailed look at past purchases, usage, and prices paid for every item in the product category under consideration. This is needed to assure that the price level and profit margin are reasonable and equitable for both parties.
6. Final proposal. A detailed plan for supplying goods that spells out prices, service levels, and quality standards.
7. Implementation. Writing the requisition, trial period, and ironing out the rough spots that could hinder the operation of the agreement.
8. Reports. Continuous auditing and reporting on how well the agreement is being implemented.



approach can usually show a distributor the benefits to his organization more easily than a distributor can demonstrate the advantages to the customer.

The distributor, on the other hand, usually needs relatively more information about how the customer's business works than the buyer would need going in the other direction. To successfully sell a partnering agreement, a distributor needs to have a very good understanding of the prospect's business before he even wins an okay to make a study. Those who have the most success in selling partnering usually attribute their success to a sales staff that is good at collecting business intelligence.

## What buyers check out

The following list of characteristics is the most common one used by buyers to determine the technical capabilities of potential supplier partners. Actual scoring varies by buyers.

### 1. Financial

a. D&B
b. Other

### 2. Progressive-aggressive

a. Market knowledge
b. Technique
c. Methods
d. Policy
e. Communications (customers and employees)
f. Growth
g. Future plans
h. Enthusiasm
i. Productivity

### 3. Product quality

Top grade vs class B, C, etc.

### 4. Location

a. Same city
b. A day away
c. Three days away
d. More than three days away

### 5. Inventory (breadth)

Length of line

### 6. Inventory (depth)

Quality of each item in the line

### 7. Inventory (performance)

a. Stockouts
b. Inventory control method
c. Inventory turns

### 8. Physical layout

a. Methods of handling
b. Identification
c. Method of processing orders
d. Fast movers in front

### 9. Admin. talent

a. Housekeeping
b. Employee attitude
c. Profitable
d. Buying patterns
e. "Hey-you" system
f. Order processing

### 10. Engineering talent

### 11. Delivery

a. Truck (own or lease)
b. Daily delivery

SOURCE: ANDERSON ASSOCIATES, ORLANDO, FLA.

Before any presentation is made, an alert distributor will need to have a good idea of whether or not there is a good inventory fit. A typical rule of thumb is to look for a customer where at least 50% of the items that would be involved in the agreement are already in the distributor's stock and another 20-30% can be added to the stock with relative ease.

But whether the partnering agreement is initiated by the distributor or the purchasing professional, there is a great deal of selling that needs to be done in the customer's plant. Partnering, for example, is going to result in sole sourcing (or at least primary sourcing) for a whole range of goods. People who use the goods will need assurance that what they will get under the arrangement is as good as, if not better than, what they have been getting. Accounting types will need to be assured that the streamlined paper trail provides proper controls. Financial managers will have to be sold on the fact that partnering is really a sound method of spending the company's purchasing dollars. And in many of these cases the distributor's help in internal selling will be the critical factor in developing partnering agreements for MRO goods.

**It ain't snake oil.** Partnering won't solve all ills of the MRO market now or the market to come. It has practical limits of application. True, it's an important means for industrial distributors to win valuable volume increases and for both buyers and distributors to trim inventory costs. But, it is also true that if you looked at the customer base of the average industrial distributor you would probably find no more than 3-5% of the current customer base that would qualify as good candidates for a partnering agreement.

In terms of volume, the numbers are somewhat better. Still, even the

distributors most active in partnering concede that their goals are to have partnering agreements account for no more than 50% of their sales volume. Many feel the reasonable topside figure may be closer to 30% than 50%.

A large number of industrial distributors do not see partnering in their future at all. They look at their businesses in conventional economic terms—as suppliers of quantities too small to be handled on a direct manufacturer-to-user basis. Buyers and distributors also agree that there is a large area of "specials" that is uneconomic to be handled under any kind of partnering agreement.

**Variations.** Even the assumptions of those who tout partnering the loudest have to be looked at closely. Many buyers and distributors tend to think of partnering in terms of what is generally called "pure systems contract agreements"—where the distributor is responsible for delivering an entire group of products at precise times, in precise quantities, and of guaranteed qualities. The service level for many of these pure systems arrangements runs between 90% and 95% fill rate within 24 hours. For many distributors the demands of this kind of an agreement are impossible to approach.

Actually, many of the most enthusiastic distributors see a much broader field of opportunity and sell variations on the theme. They sell modified programs based on one or more of the benefits generally attributed to partnering—paperwork elimination, inventory reduction, improved material flow, even better overall goods pricing. Typical variations include special stocking agreements, toolroom maintenance agreements, material management agreements, special kitting arrangements (where the distributor supplies all the tools or materials for a particular job in kit form), and long term blanket agreements where all of the characteristics of a systems contract are in place—but the agreement is verbal.

**How small?** Whether distributors are looking at the pure form or variations on the theme, partnering agreements do involve sizable costs. There must be a potential business volume to make such agreements cost effective for the distributor. How much volume is needed? That depends to a great extent on the level of service to which the distributor is committed. There's no hard and fast rule, but most distributors who have been in the partnering game for any time seem to hit on a figure of around $50,000 to $100,000. That's for a contract where the distributor is bound to a set standard of performance. Many distributors, however, will start a partnering agreement on a lower volume if the potential for future volume is there or if a lower level of service is acceptable.

**Prices vs costs.** Another of the sticky stumbling blocks to effective partnering revolves around prices. Many buyers want the distributor's better service level, but insist on the manufacturer's price. And that's a next to impossible demand on MRO-type goods. Partnering agreements are usually viable only when the volume covers a fairly broad product family and the pricing is based on a full range of products. If buyers are allowed to cherry pick the product line for the best prices, partnering will not work. The distributor needs all of the non-special items in the product line or the agreement will not work.

Pricing, therefore, can be a very serious complication in many partnering arrangements. On the distributor side, many companies persist in looking at pricing in terms of gross margins—without realizing the increases in productivity in his operation and the higher volumes will radically alter the economics he has become used to working with. On the other side, industrial buyers often try to compare the prices in a local partnering agreement with national contract prices. A national blanket contract works well where large volumes of a single item or a few items are involved. They don't work at all where multiple items are involved and where a specified level of service is more critical than a cheap price. *(continued)*

## Partnering: The Four Commandments

While implementation of partnering agreements requires a great deal of work at the distributor-buyer level, distributors with good track records say there are also four very important steps to follow in winning the cooperation of their manufacturer suppliers.

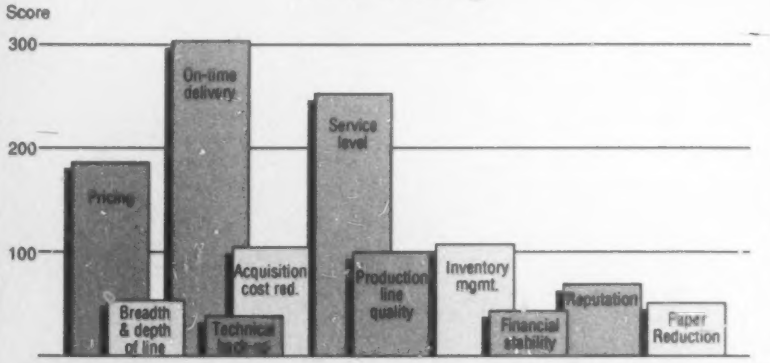
1. Be forthright with suppliers from the beginning. Emphasize to each key supplier that you intend to become the sole source of a line of products to this customer. Tell each that you need and expect help in pricing, service, and quality assurance.

2. Make sure the supplier understands early in the game that the key factor in your sales story is service level.

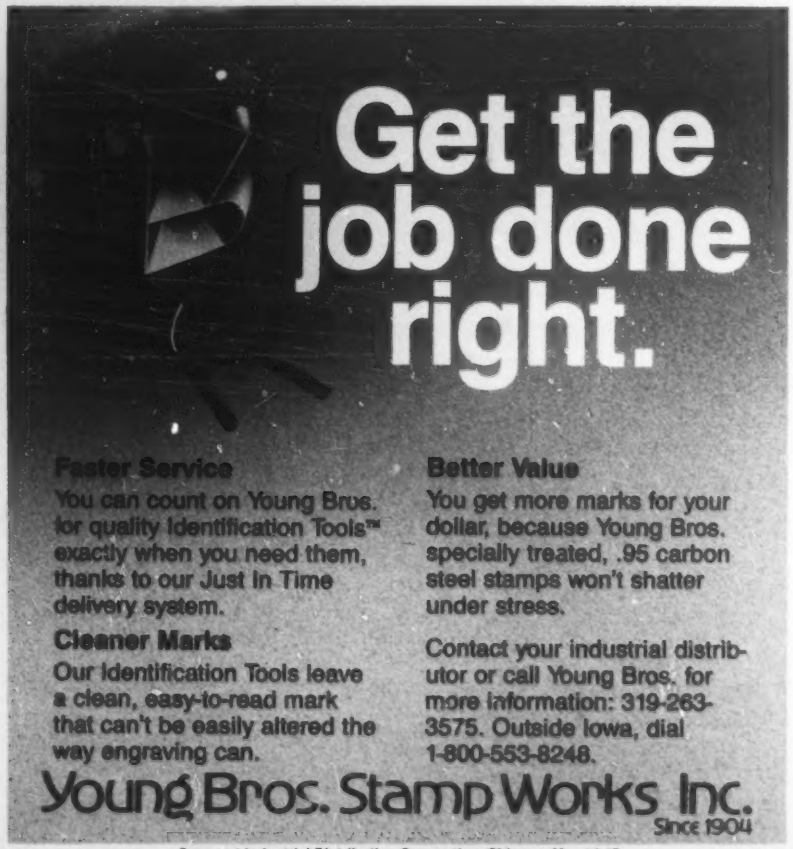
3. Point out to the supplier that you want to continue to sell and represent his products in your territory and that the agreement will help to assure the growth of his company's product sales in your territory.

4. Back up your reassurances. As soon as possible establish a positive information program that periodically informs him on how you are selling his product and on future prospects. Make sure the information program is open-ended and gives him opportunity to introduce and explain his new products to your sales staff.

## The most important factors in selling




Service before price is the way distributors view what sells partnering-type agreements according to a recent study conducted by the Distribution Research & Education Foundation of the National Assn. of Wholesale-Distributors. Weighted score shows relative importance of each factor.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Indeed, many distributors who have been working at selling partnering agreements for a number of years say that getting buyers to stop thinking of them as glorified blanket contracts is one of the hardest hurdles they face. The irony is that many of their competitors are responsible for keeping the waters murky. Often competitors see the volumes involved in a partnering agreement and begin to key in on the business in terms of price. Without an understanding of the service level involved in the partnering agreement, the competitor with the low ball bid soon finds he is unable to deliver on his promises because he has not made any of the changes in his operating procedures that will lower his servicing costs.

Most good partnering agreements will result in major reductions in purchasing and distribution transaction costs. They will also greatly reduce inventory and increase output per employee both in the purchasing department and in the distributor's place of business. In many cases they will also result in lower overall pricing. Unfortunately too many people on both sides of partnering still look at individual prices before they ever look at the real economic benefits.

**Eight plus eight plus four.** Whether the agreements are being sold by purchasing or distribution, certain steps must be followed and documented or they won't work. There are eight steps that buyers must follow when selling partnering to distributors; and a different set of eight steps when the distributor is doing the selling. Although in many respects the steps are similar, they all must be followed for good partnering to result.

In addition to these selling steps, there are four "commandments" that distributors must follow in relation to the manufacturer/supplier if partnering agreements are to work. (See related sidebars.) ■


Circle No. 14

# BUSINESS REPORT

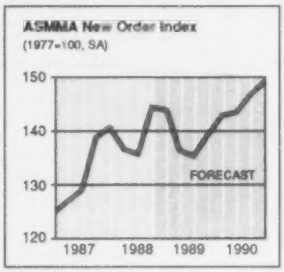
BY KRIS BLEDOWSKI

# Heavy equipment sales up

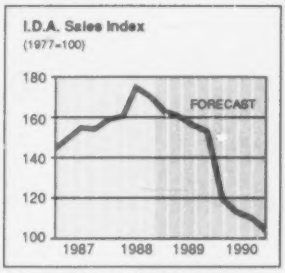
*Nonelectrical machinery sector is hot*

Nonelectrical machinery grew at an enviable rate of 13.8% in 1988 when measured by the value of shipments. The strongest sectors have been metalworking machinery, which includes machine tools, rolling mill machinery and various hand tools. Shipments of this category jumped 17.9% in 1988. Orders for machine tools have been running at an annual rate of over 70%, and a large order backlog guarantees continuing strong performance this year as well.

However, foreign orders are not expected to match last year's record levels, thus depressing growth. Consequently, shipments of metalworking machinery as a whole are forecast to inch up only 2.7% in 1989 even though machine tools will grow in double digits.



Data source: ASMMA
Forecast source: Cahners Economics



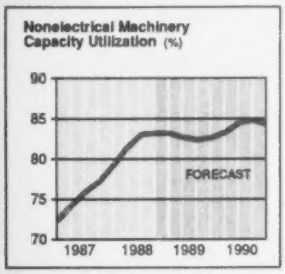
Data source: Industrial Distribution Assn.
Forecast source: Cahners Economics

Another category showing strength is heavy machinery used for construction, mining and oil exploration as well as materials handling equipment. Shipments of these products rose 16.1% last year, propelled mainly by strong gains in both commercial and residential construction. As capital spending on equipment and structures rose over 10% in 1988, heavy nonelectrical machinery got a large chunk of it.

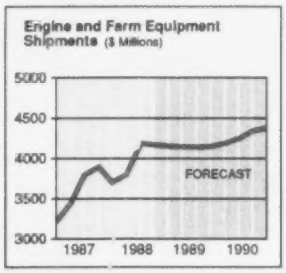
Record output in the aerospace and automotive sectors drove engine and turbines shipments up 10.8% last year, mainly due to strong orders from commercial jet makers and passenger auto companies. A large backlog of aircraft orders will send shipments of this category up 4.7% this year and another 3.4% in 1990.

Nonelectrical machinery as a whole has benefitted from an investment boom and increased foreign demand in 1988. However, this pattern is not likely to continue at the same pace. For one, exports will not show as much vigor due to a firming dollar and capacity constraints. American manufacturers still treat export markets as residuals, and if strapped for capacity, will always favor domestic end markets.

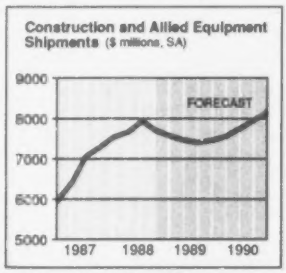
The capital spending spree will also cool off towards the end of the year as domestic demand slackens. One element stimulating growth will be low inventories and resulting trimmed inventory-shipments ratios. Expect shipments of nonelectrical machinery to advance 3.0% this year, 5.2% in 1990. □



Data source: Federal Reserve Board
Forecast source: Cahners Economics



Data source: Dept. of Commerce
Forecast source: Cahners Economics



Data source: Federal Reserve Board
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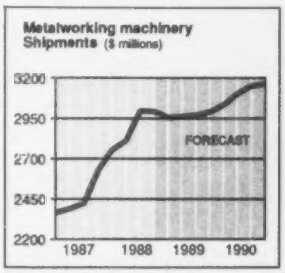


Data source: Dept. of Commerce
Forecast source: Cahners Economics

| | SALES Average % Change | | INVENTORIES Increase | | No Change | Decrease | |
|---|---|---|---|---|---|---|---|
| | Jan. '89 vs. Dec. '88 | Jan. '89 vs. Jan. '88 | Percent Responding | Average Increase | Percent Responding | Percent Responding | Average Decrease |
| EAST | −0.3 | 13.2 | 29.6 | 3.3 | 37.0 | 33.3 | 3.7 |
| SOUTH | 10.1 | 30.2 | 52.4 | 5.5 | 33.3 | 14.3 | 4.7 |
| CENTRAL | 8.5 | 18.9 | 34.9 | 4.4 | 41.9 | 23.3 | 4.1 |
| WEST | −3.7 | 1.1 | 25.0 | 3.1 | 40.0 | 35.0 | 3.1 |
| TOTAL | 2.9 | 17.8 | 35.1 | 4.3 | 38.7 | 26.1 | 3.8 |

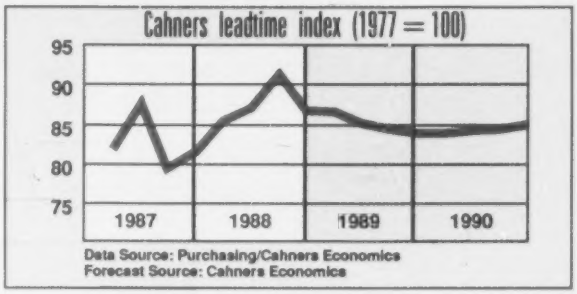
# SUPPLY OUTLOOK

BY KRIS BLEDOWSKI

# Price rises accelerate

*High capacity utilization pushes inflation up*

There are signs that tight supply conditions are finally showing up in higher prices for primary inputs and intermediate materials such as lumber, hardware and other building materials. This is a direct result of high capacity utilization rates in primary process industries as well as long leadtimes for chemicals, paper and metals. Producer prices for intermediate materials have been steadily edging up.

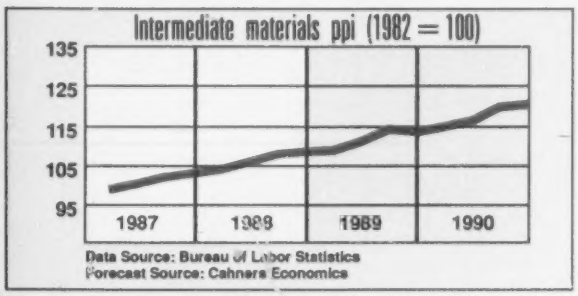



From an annual inflation rate of 2.4% by the end of 1987, prices went up 4.4% by the spring of 1988, and posted a 5.6% gain in January of this year. Inflation is expected to run at over 5% at least through the first half of 1990.

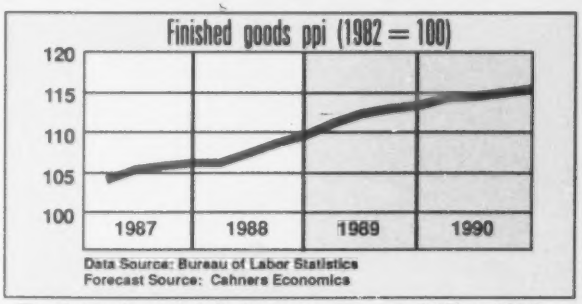
Advances in producer prices for intermediate products like gas and electricity have been higher than the overall producer inflation for finished goods. From an annual rate of 2.1% by the end of 1987, prices inched up only 2.7% by January of this year. However, January's monthly jump of 0.9% portends much higher rates. We forecast annual inflation to reach 4.1% by the end of the year, while the Fed makes controlling inflation its top priority.

Tight supply conditions sent prices of selected product groups sharply higher. Fabricated metals inflation, for example, was running at an annual rate of 1.8% in December 1987 but reached 8.7% by January of this year. Meanwhile, power transmission equipment prices rose at a 3.8% annual rate in January, up from 1.2% in the same period a year before.

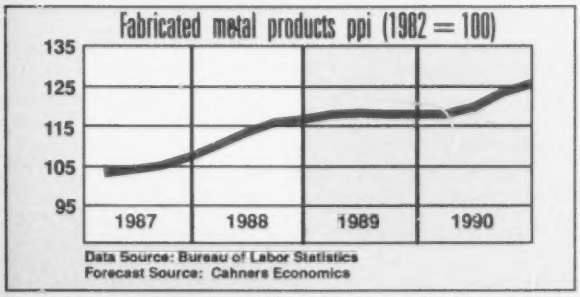
The underlying trend is for cost-push inflation to finally manifest itself after a long expansionary period during which capacity was underutilized. Now that the unemployment rate is about 5%, close to what economists call "the natural rate," higher wages will also exert upward pressure on total costs and, ultimately, prices at both the producer and consumer levels. □



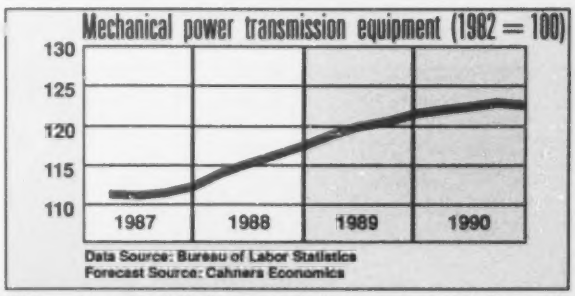

**Expect prices for intermediate materials to top 4.9% by the end of the year because of tightening supply conditions.**




**The finished goods inflation rate will reach 4.1% in 1989; expect the Fed to move in on the prime.**




**Prices of fabricated metals, like castings and forgings, shot up to an annual rate of over 8%.**




**After a long non-inflationary period, power transmission products are becoming more expensive.**

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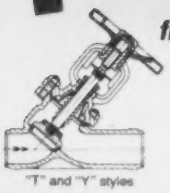

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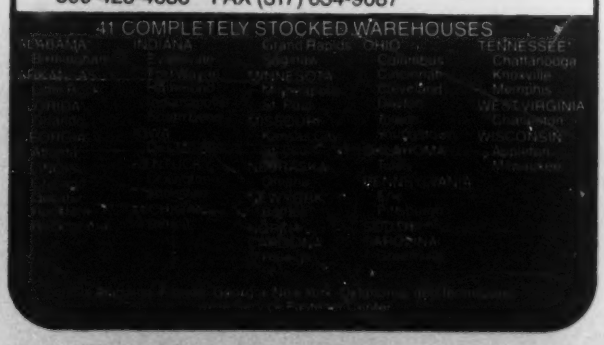
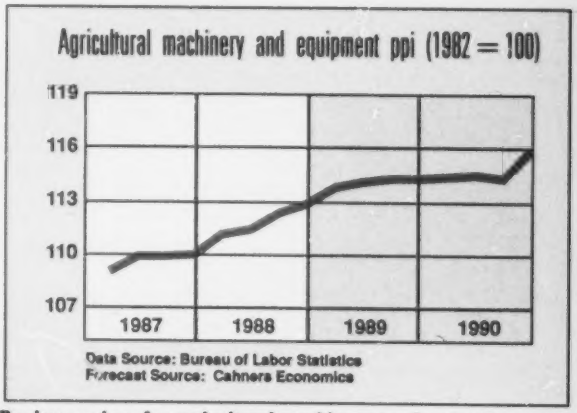




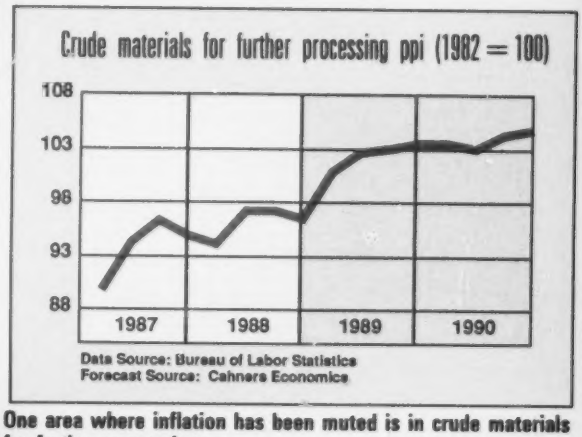
# SUPPLY OUTLOOK

## Weak dollar spurs metalworking's output

Output of fabricated metal products rose a substantial 8.9% last year after meager growth of 2.7% in 1987. The reason lies in high demand for fasteners, stampings and forgings, which grew over 10%. Automobile and aerospace industries accounted for the bulk of stampings and forgings orders. In the subcategory of impression die forgings, orders totalled a record $3 billion in 1988, about 18% higher than in the previous year. Structural metal products (metal doors, sheet metal, etc.) also showed strength. Output of this category advanced 6% in 1988 while hardware, tools and cutlery grew about 7%.




**Producer prices for agricultural machinery are forecast to remain stable through the end of the decade.**




**One area where inflation has been muted is in crude materials for further processing.**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